

Chapter 10

Section 8 Contract Renewal with a Reduction of Section 8 Rents without Debt Restructuring (“Lites”)

Executive Summary

SECTION 10-1

In accordance with Housing Notice H 99-36 or subsequent guidance, owners may elect to renew Section 8 HAP Contracts at market rents without debt restructuring. These transactions are called “Lites”. This chapter (which supersedes Section 10-4 of the Guide, as revised) discusses the processing and underwriting of these transactions - both those that can be approved as Lites and those that prove ineligible as Lites. The procedures would also be generally applicable to Full Debt Restructuring transactions that have been reclassified as Lites because their rents are above-market but Full Debt Restructuring is not needed.

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Owner's Request for a Lite

SECTION 10-3

Owners who wish to renew Section 8 HAP Contracts at market rents without debt restructuring must select that option in accordance with Housing Notice H 99-36 (or PIH 99-22 in the case of Moderate Rehabilitation properties) or subsequent guidance¹. The owner should submit the following attachments to the Multifamily Hub or Program Center no later than 120 days prior to contract expiration:

1. a comparable market rent study;
2. the most recent required fiscal year audited financial statements for the project; and,
3. an owner's evaluation of physical condition.

Thereafter, the owner must also submit such other documents as the PAE or HUD may require.

HUD Initial Processing; Section 8 HAP Contract Renewal; Contract Administration

SECTION 10-4

- A. Assignment to OMHAR.** The Multifamily Hub or Program Center will receive the owner's request for a Lite. HUD and OMHAR have agreed that Mark-to-Market eligible Lite transactions will be processed by OMHAR. The Multifamily Hub or Program Center will log in the request, update the REMS system for the type of renewal requested, and forward the asset to OMHAR for assignment to a PAE (see Chapter 1).
- B. Section 8 HAP Contract Renewal.** When the owner submitted his or her election under H 99-36, the Section 8 HAP Contract was extended for an additional six months. If this initial extension will expire before the PAE has completed the transaction, the PAE will request that the HUD

¹ References to HUD Notices refer to the actual notice or earlier or subsequent related guidance.

Project Manager reserve funds and execute an additional Section 8 HAP Contract extension, using the appropriate H 99-36 attachment, upon expiration of the existing contract. When the PAE request is received, the HUD Project Manager will reserve funds and renew the Section 8 HAP Contract for six months at the contract's current Section 8 HAP Contract rents. The extended Section 8 HAP Contract expires at the earlier of six months or at the end of the first full month after notification to the owner of the determination of comparable market rents.

- C. **Transactions Found Ineligible as Lites.** Some transactions will be found ineligible as Lites, and the PAE will recommend conversion to Full Debt Restructuring. The owner will be advised of this determination and provided an opportunity to change his or her election under H 99-36. Where the owner elects to change his or her election to Full Debt Restructuring, the HUD Project Manager will provide a new Section 8 HAP Contract and Rider appropriate for Full Debt Restructuring transactions. This contract is provided when the owner's revised election under H 99-36 is received. This contract, coupled with the prior contract, may total no more than 12 months at the current (pre-Mark-to-Market) contract rents.

If an extension beyond 12 months is eventually needed, an extension at **OMHAR-approved market rents** may be granted by the HUD Project Manager. The HUD Project Manager should request the market rent determination from OMHAR well in advance of the renewal.

If the extension is needed principally because of administrative delays in the assignment and acceptance of the asset, a waiver may be requested of OMHAR to extend the contract at the current rents.

- D. **Section 8 Moderate Rehabilitation.** If the owner of an eligible Moderate Rehabilitation property requests a Section 8 HAP Contract renewal under the Mark-to-Market program, the HUD Office of Public Housing Hub Director or the Program Center Coordinator will forward the request to the Multifamily Hub or Program Center Director for processing and referral to OMHAR. As noted in Notice PIH 99-22, the contract administration responsibilities remain with the PHA during the processing.
- E. **Combining Contracts.** A project with multiple Section 8 contracts, or stages, which is requesting a Section 8 HAP Contract renewal without debt restructuring under the Mark-to-Market program may request to combine them into a single contract. Contracts executed before January 1, 1981 may not be combined with contracts executed after that point.

- F. **Transfer of Contract Administration.** A qualified public-entity PAE may elect to be the Section 8 Contract Administrator for any property whose owner pursues Section 8 HAP Contract renewal at reduced rents (with or without debt restructuring). An Annual Contribution Contract (ACC) will be executed with the Office of Housing, and contract administration will be transferred either upon project assignment by OMHAR or after the execution of the Section 8 HAP Contract reflecting the final OMHAR determination. Procedures for this transfer will be provided in the future. Qualified Public-Entity PAEs should contact OMHAR's Section 8 coordinator at OMHAR Headquarters (202-708-0001) if more information is needed on this topic.

Summary of Lites

SECTION 10-5

- A. **General.** Lite transactions involve a streamlined review by the PAE that differs in both scope and intensity from the review for a Full Debt Restructuring transaction.

The purpose of the review is to determine whether the project's long term **financial, physical, and managerial** soundness can be assured through Section 8 HAP Contract renewal at reduced rents, without the need to reduce the principal amount of the FHA-insured loan through a partial payment of claim.

- B. **Processing Time.** Under the PRA, the PAE's work on a Lite, Tier 1 transaction is to be completed within 90 days (75 days to receive an incentive payment). Where Form 2.16, Letter from PAE to OMHAR to Request a Change of Asset Status, has been approved converting the asset to a Lite, Tier 2, an additional 30 days is granted and the work is to be submitted within a total of 120 days, (90 days for an incentive payment). The "clock stops" for determining the PAE's time whenever (1) OMHAR has the completed work product under review, and (2) for (up to) the 20 business day period the owner has to consider conversion to Full Debt Restructuring (counting from the date the letter to the owner is sent). PAE's should retain the evidence of mailing in the case of overnight mail, or the return receipt where overnight mailing services are not available.

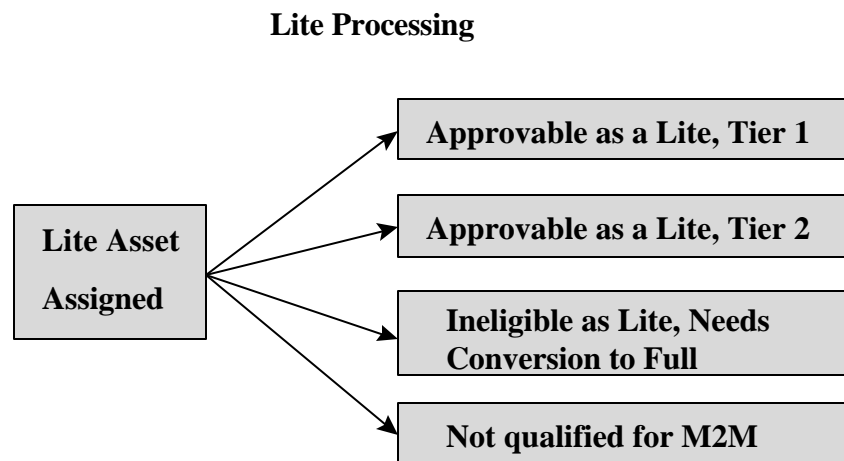
- C. **Comparison to Full Debt Restructuring.** In comparison to Full transactions, a Lite requires:

1. No debt reduction; no 2nd or 3rd mortgage; no FHA claim payment. There **may be** refinancing of the existing debt to reduce debt service through lower interest rates and/or longer amortization.

2. A Market Rent Study rather than a Limited Scope Appraisal.
3. No Rehabilitation Escrow. Critical (health and safety) repair needs must be completed immediately and immediate (first year) repair needs must be completed, or adequate funds must be present in the Replacement Reserve Account, as preconditions for the PAE's recommendation in favor of Section 8 HAP Contract renewal.
4. No kick-off meeting with the owner.
5. No Required Tenant Meeting. (See Section 10-7 B.) Tenant comments are solicited in writing in lieu of tenant meetings.
6. No requirement to execute a Mark-to-Market Use Agreement.
7. A single PAE invoice per transaction (not including reimbursables).
8. No Closing File.

Lite Processing Options

SECTION 10-6



- A. **General; Initial Review.** All transactions submitted as Lites will initially be reviewed for financial, physical, and managerial soundness under Tier 1 (underwriting standards are described in Section 10-7 below). Notification forms are provided and owner consideration and appeal timelines are included in the forms. See each form for specific guidelines.

Where the PAE receives adequate information from the owner **prior to ordering third party reports**, the PAE will determine the current Debt Service Coverage Ratio (DSCR) using the current contract rents and the most recent expenses. If the existing DSCR is lower than that required for approval as a Lite Tier 1 or 2, the PAE will:

1. Immediately proceed as in paragraph E of this Section (using Form 10.6(b) Notification to Owner of Ineligibility as a Lite based on *Initial Review*), offering the owner the option to change his or her election under H 99-36. Upon receipt of the owner's response, the PAE will proceed in accordance with paragraphs F (owner changes election), G (owner appeals), or H (owner rejects change of election) below, as applicable; and,
 2. **Without waiting for any appeals, order the third party reports. In this case, however, even if the transaction will ultimately be processed as a Lite under paragraph G,** the PAE must order a Limited Scope Appraisal (as for a Full Debt Restructuring) rather than the market study normally obtained for a Lite. The statement of work for the appraiser should be amended to include a determination of rents on both an “as is” and “as repaired” basis. (See Appendix H.)
- B. **Approval as a Lite.** If the PAE determines that the transaction can be approved as a Lite, Tier 1, the following procedures apply.
1. The PAE will complete the electronic submission shown in Form 10.2, Electronic Submission of PAE's Lite Conclusions.
 2. The PAE will submit the narrative and conclusion described in Form 10.1, OMHAR Reduction in Rent and Section 8 HAP Contract Renewal Justification and cover page, to OMHAR, with a print out of the electronic submission (Form 10.2). This submission should address the issues covered in the Sections that are cited in the Form 10.1.
 3. OMHAR will review the PAE's recommendation, obtain any necessary corrections, accept or adjust the market rents, and draft a new Section 8 HAP Contract using the appropriate form from H 99-36. OMHAR will estimate the Budget Authority and insert this amount in the new contract as the maximum amount of Housing assistance authorized for that contract.
 4. OMHAR will send the PAE Form 10.3(a), Market Rent Determination, and attach the new Section 8 HAP Contract for execution by the owner. A copy of this notice will be used by the PAE as support for its invoice for payment for its work on the transaction.
 5. OMHAR will also send a copy of the Section 8 HAP Contract to the HUD Project Manager.
 6. The PAE will send the Section 8 HAP Contract to the owner using Form 10.4(a), Notification to Owner of Market Rent Determination.

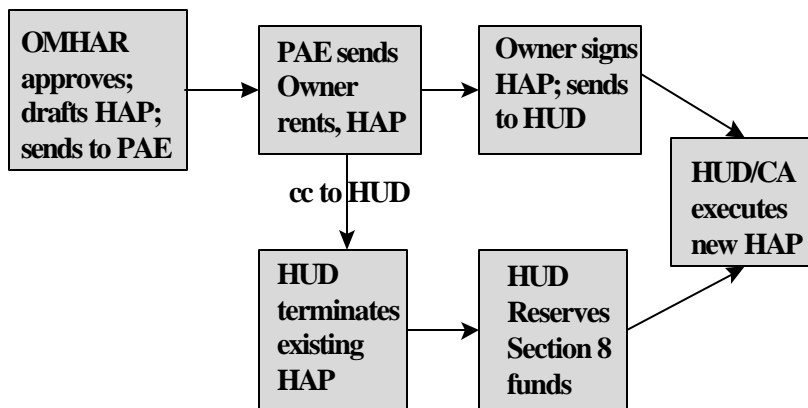
The owner must execute the contract by the due date established in the letter (10 days from issuance) and provide the executed contract to the HUD Project Manager. Owners must also provide a new rent schedule reflecting the approved rents and gross rent change certifications for tenants to the HUD Project Manager. Gross rent changes do NOT require recertification of tenant income or expenses and do not affect annual recertification schedules (see Handbook 4350.3, Chapter 3 and Appendix 11). If the Section 8 HAP contract is not executed by the due date, HUD will be unable to honor the owner's vouchers under the higher rents and will have no choice but to assume that the owner intends to opt out of the Program.

This notice includes guidance to the owner on appeals. Execution of the contract does not interfere with the owner's ability to appeal.

The PAE will use the Form 10.4(b) cover letter, Notification to HUD Project Manager of Market Rent Determination, to provide a copy to the HUD Project Manager of the Notification to the Owner, so that the existing HAP Contract can be terminated and the fund reservation process for the new HAP Contract can begin. The PAE should provide an additional copy, including the cover letter, to the Section 8 Contract Administrator and the OMHAR Regional Office.

The PAE will assure that the Mark-to-Market MIS system data is complete. This includes entering the date the Section 8 HAP Contract was sent to the owner and the date the PAE received a copy of the Section 8 HAP Contract signed by the owner.

PAE Determines Transaction is Approvable as a Lite



7. Upon request, the PAE will supply the owner with the information it has used to reach its tentative conclusions (the PCA and Market

Study/Limited Scope Appraisal, if completed, the draft income and expense spreadsheet, and the PAE's justification for its selection of market rents). These materials should be provided by overnight mail.

8. The HUD Project Manager will: (a) terminate the existing Section 8 HAP Contract as of the expiration date listed in the Notification to Owner as described in Form 10.4(b), and (b) prepare to complete the fund reservation and execution process for the new Section 8 HAP Contract when received from the owner. The HUD Project Manager will also update the REMS system when processing is completed. **These Section 8 HAP Contract execution procedures should proceed regardless of any appeals process.**
9. The **owner should execute** the Section 8 HAP Contract, prepare a new rent schedule reflecting the approved rents and gross rent changes for tenants in the project and provide this to the HUD Project Manager, with a copy to the PAE.
10. If the **owner fails to execute** the contract, future owner vouchers for Section 8 funding under the existing contract will not be paid. OMHAR will inform the HUD Project Manager that a copy of the new Section 8 HAP Contract has not been received by the PAE by the due date and to assume that the owner intends to opt out. If tenant-based assistance to the tenants is required, the HUD Project Manager will provide the owner with a short-term renewal in order to comply with the one year notice requirements to tenants and/or to provide sufficient time to process tenant vouchers.
11. If there is an **appeal**, OMHAR will discuss the appeal with the PAE and reach a final determination. If the appeal:
 - a) **results in an increase** in the market rents, OMHAR will provide a revised Form 10.3(a) and a revised Section 8 HAP Contract to the PAE (with a copy to the HUD Project Manager and the Section 8 Contract Administrator). The PAE will send Form 10.5, Notification to the Owner of Results of Appeal of Market Rent Determination, with the revised Section 8 HAP Contract indicating that rents have been increased and the appeals process is complete. The PAE should provide a copy of the notice, using the Form 10.4(b) cover letter, Notification to HUD Project Manager of Market Rent Determination, to the HUD Project Manager, with a copy to the Section 8 Contract Administrator and the OMHAR Regional Office.
 - b) **does not result in an increase** in the determination of market rents, OMHAR will notify the owner, using Form 10.7(a),

Notification to Owner of Failure of Appeal, with a copy to the HUD Project Manager, Section 8 Contract Administrator, and the PAE, that the review is finished and the appeals process is complete.

C. **Ineligibility as a Lite, Tier 1.** At any time during its review, the PAE may determine that the transaction is not eligible as a Lite, Tier 1. This determination may be made when the PAE has completed Tier 1 underwriting or earlier in the process so long as the PAE has sufficient evidence to support its conclusion. In any case where the transaction is found ineligible as a Tier 1, the PAE will determine whether the transaction:

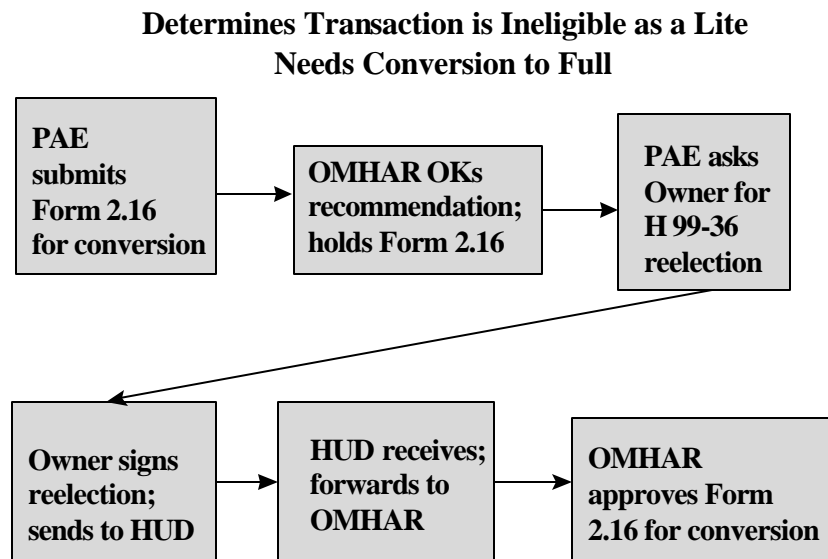
1. **may be approved as a Lite, Tier 2.** (Underwriting standards are in Section 10-8.D. below.) In this case, the PAE will follow the procedures in paragraph D below. Or,
2. **requires a Full Debt Restructuring.** (Underwriting standards are in the earlier Chapters of this Guide.) In this case, the PAE will follow the procedures in paragraph E and paragraphs F, G, or H below, as applicable. Or,
3. **is ineligible for Mark-to-Market or otherwise cannot be approved at all.** In this case, the PAE will follow the procedures in paragraph I below.

D. **May be Approved as a Lite, Tier 2 Transaction.**

1. If the PAE determines that the project may be approvable as a Lite Tier 2, it must submit Form 2.16 to the appropriate OMHAR Regional Office briefly justifying its conclusion.
2. The OMHAR Regional Office will review Form 2.16 and, based on its review experience with the PAE, may request review of any information the PAE will provide to the owner.
3. After OMHAR approves Form 2.16, the PAE will complete any necessary discussions with the owner (especially where substantial expense reductions or refinancing of existing debt are required) and process the transaction as a Lite Tier 2, following the standards in Section 10-8 below.
4. If the transaction is found **approvable as a Lite, Tier 2** the PAE will proceed with the approval as outlined in Section 10-6.B. above. If a refinance is required in order to be approvable as a Lite, a condition must be included in the Section 8 HAP Contract to the effect that the owner has agreed to refinance before the next contract renewal.

If the transaction is found **not eligible as a Lite, Tier 2**, and would only be approvable as a Full Debt Restructuring, the PAE will proceed as indicated in paragraph E.

E. May be Approved only as a Full Debt Restructuring.



If the PAE determines that the project will only be approvable as a Full Restructuring, it will submit Form 2.16. The PAE should include a brief justification of its conclusion including a summary of the income and expenses used, and the DSC concluded. The OMHAR Regional Office, based on its review experience, may request review of any information to be provided to the owner. (Alternatively, the PAE, in its discretion may submit the completed Tier 1 or 2 Lite work product for review and approval. After approval, the PAE can submit an invoice to OMHAR for the Lite work, and include Form 10.3(b), Agreement with PAE's Determination of Ineligible Lite, as support.) After completion of any review determined necessary by OMHAR, OMHAR will hold Form 2.16, but will notify the PAE, using Form 10.3(b) to proceed as follows:

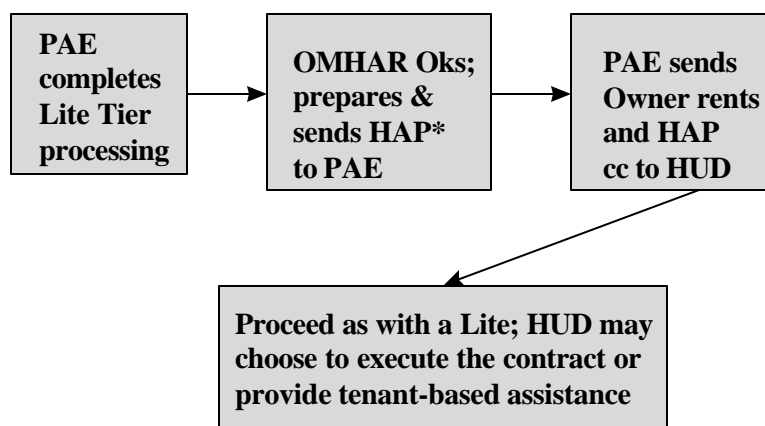
1. The PAE will request a teleconference or meeting, with the owner.
2. The PAE will advise the Multifamily Hub or Program Center (and the Section 8 Contract Administrator, if not HUD) of this teleconference or meeting and invite their participation. In many cases, the Multifamily Hub or Program Center (and the Section 8 Contract Administrator, if not HUD) may be very helpful to the PAE in these discussions with the owner. If requested, the PAE should work with the Multifamily Hub or Program Center (and the Section 8 Contract

Administrator, if not HUD), by supplying reasonable transaction information or otherwise, to help it to be supportive in the upcoming meeting.

3. In the teleconference or meeting, the PAE will advise the owner of its tentative conclusions (conclusions that may not yet have been fully reviewed by OMHAR), explain the owner's options, and the forthcoming Form 10.6(a) or (b) Notification to Owner of Ineligibility as a Lite; Transmittal of Form for Re-election under H 99-36. (Note that the Form 10.6(a) is used in all cases except where the determination of ineligibility is made as part of the Initial Review referenced in Section 10-6 A above where a determination of market rents has not yet been made. In this latter case, Form 10.6(b) is used.)
 4. After the teleconference or meeting, the PAE will send the Form 10.6(a) or (b) notification to the owner, with a copy of the election form, asking the owner to change his or her election under H 99-36 and providing 20 business days to appeal the determination that the property cannot be approved as a Lite and/or to appeal the rents tentatively determined.
 5. Upon request, the PAE will supply the owner with the information it has used to reach its tentative conclusions (the PCA and Market Study/Limited Scope Appraisal, if completed, the draft income and expense spreadsheet, and the PAE's justification for its selection of market rents). These materials should be provided by overnight mail.
- F. Owner Elects Full Debt Restructuring.** If the owner revises his or her election to a Full Debt Restructuring, the owner will provide the revised election to the Multifamily Hub or Program Center (with a copy to the PAE). The PAE will submit a copy of the election to the appropriate OMHAR Regional Office in support of the Form 2.16. When Form 2.16 (previously submitted) is approved, the PAE may process the transaction as a Full Restructuring as described in the other Chapters of this Guide. The PRA provides for up to an additional 12 months for completion of processing; thus, the total time the PAE has the transaction for processing may exceed 12 months. (This should not be confused with the time that the owner's Section 8 HAP Contract may be extended at current rents; absent a waiver, this period cannot exceed 12 months total.)
- G. Owner Appeals Determination of Need for Full Debt Restructuring and/or Appeals Market Rent Determination.** If the owner appeals the determination that the transaction is unapprovable as a Lite and/or appeals the market rent determination, OMHAR will review the appeal and respond to the owner within 30 calendar days.

1. If the appeal is rejected, OMHAR will notify the owner using Form 10.7(b), Notification of Failure of Appeal. In this case, the owner will have an additional five business days to revise his or her election under H 99-36.
2. If OMHAR's response to the appeal is positive, OMHAR will draft a response to the owner, with a copy to the PAE, advising them of the determination and the basis for it and how processing should proceed (i.e., if Tier 2 processing is in order, or if market rents should be revised but the transaction be completed as a Lite and put on the watch list, etc.).

H. Owner Rejects Full Debt Restructuring, or Fails to Respond.



***Section 8 HAP Contract specifies property will be on watch list; retains eligibility to come in as Full**

If the owner refuses Full Debt Restructuring, or fails to respond to the PAE's letter within 20 business days, or fails to respond within 10 business days to OMHAR's letter turning down the appeal, the PAE will complete processing of the transaction at the current Lite tier, i.e., complete Tier 1 processing (Paragraph B above), or complete Tier 2 processing (paragraph D above) if a previous Form 2.16 converting the transaction to a Tier 2 was approved. Then,

1. OMHAR will review the PAE's recommendation, obtain any necessary corrections, accept or adjust the market rents, and draft a new Section 8 HAP Contract.
2. OMHAR will provide a Form 10.3(c), Ineligible Lite/ Conversion to Full Refused, to the PAE with the approved market rents and the Section 8 HAP Contract. OMHAR will send a copy of this letter to the HUD Project Manager and Section 8 Contract Administrator. The Multifamily Hub or Program Center will determine whether to continue project-based assistance at the

OMHAR-approved market rents, or whether to issue tenant-based vouchers to residents. If project-based assistance is used, the HUD Project Manager will execute the amended Section 8 Contract that maintains the owner's eligibility in OMHAR in case the owner at a later date decides to change his election to Full Debt Restructuring. The amended contract stipulates that the project will be placed on the "watch list" for Multifamily Housing to monitor.

3. The PAE will provide Form 10.8, Notice to Owner/Conversion Refused, to the owner and provide a copy, using cover letter Form 10.4(b), to the HUD Project Manager and Section 8 Contract Administrator. The letter to HUD should include the PAE's narrative, financial analyses, and PCA to assist HUD in determining whether the HAP Contract should or should not be renewed.
 - I. **Not Approvable.** In some cases, the PAE may determine that the transaction is basically ineligible for the Mark-to-Market program, or cannot achieve managerial, physical and financial soundness under any approach. In these cases, the PAE will contact the OMHAR Regional Office to discuss the appropriate approach.
 - J. **Completion of Work.** The PAE must complete Lite processing by completing the Credit File in accordance with Form 10.9. (However, the invoice for payment may be submitted upon OMHAR's approval of a Tier 1 or 2 Lite work product described in Form 10.1.) In addition, upon completion of processing, the PAE should supply the HUD Project Manager with a copy of the PCA and the PAE's final determination of needs and deposits over the term. The PAE must also maintain the Contract File.

Lite Tier 1: Review and Underwriting

SECTION 10-7

- A. **Procedures for Review of a Lite Tier 1 Transaction; Underwriting Standards for Tier 1 Transactions.** All transactions submitted as Lites will be reviewed for financial, physical, and managerial soundness. If a transaction is determined (a) physically sound, (b) managerially sound, and (c) financially sound by achieving a 1.20 DSCR of existing debt service using market rents and the limited underwriting described below, the PAE will recommend Section 8 HAP Contract renewal at market rents. The PAE will follow the procedures described below and provide the appropriate support for their conclusions in Form 10.1.

Revised 12/19/00

B. Notification of Tenants. The PAE must notify, or ensure that the owner notifies, all parties described in Section 3-9.C., that the owner has applied for a Section 8 HAP Contract renewal without mortgage debt restructuring (See Form 10.10). The notice must be provided, in writing, to the tenant of each unit in the project and to any organizations representing project tenants. The notice must state that the following information will be made available for inspection.

1. the owner's evaluation of physical condition (if any); and
2. the owner's comparable market rent analysis (with addresses identifying data on comparable market rents redacted).

The notice must be posted in the manner provided in Chapter 3, Section 3-9.C.2 and C.3. Tenants and other interested parties may submit comments to the PAE within 30 days of receipt of this notice and the PAE must document and consider these comments. At the option of the PAE, surveys or sampling phone calls may be used to elicit additional tenant input.

C. Determine Managerial Soundness. The PAE will consult with HUD staff, consider tenant comments, and determine the acceptability of project management, generally as described in Chapter 4, Section 4-8. If the project fails to demonstrate **managerial soundness**, the owner can propose an acceptable new manager and still be processed at Tier 1 or Tier 2, if otherwise appropriate.

D. Determine Physical Soundness.

1. The PAE must obtain a PCA (including the environmental checklist) and determine the property's current condition and its Reserve needs for the forthcoming 20 years. The PAE's analysis of adequate reserves will cover the lesser of 20 years or the remaining term on the existing insured loan. However, the PCA is always prepared for a 20-year period.
2. The PAE should engage a qualified physical inspector following the guidance in Appendix I.
3. The PAE's physical inspector should conduct a review of the project's physical condition and an assessment of its Reserves for Replacement as set forth in Appendix I.
4. The PAE will review the PCA submitted by the physical inspector. The PAE will identify material errors, inconsistencies, or other deficiencies, obtain revisions if necessary and make any needed corrections in the projected reserve needs or elsewhere. Where any correction is made, the PAE must describe the error and provide a

clear and specific justification for each correction. The PAE will also confirm that any tenant and local community group comments have been considered.

5. The property will meet the Physical Soundness criterion if:
 - a) The PAE determines that the property is currently in acceptable condition and can remain so for the remaining term of the mortgage. The PAE should consider any REAC inspection findings in developing this conclusion. (If the REAC score is lower than 60, the transaction will generally require a Full Restructuring or other more comprehensive action. Where the REAC score is low, the PAE should describe the reason for the low rating and how this issue is addressed.)
 - b) Any Uniform Physical Condition Standards (UPCS) violations or other health and safety items have been cured prior to issuance of any PAE recommendation in favor of Section 8 HAP Contract renewal. The PAE need not reinspect the property but should obtain a statement or invoice from the owner indicating that the work is complete. Upon request of the PAE, the processing “clock” may be stopped if the PAE’s work is complete and the owner has not yet completed the correction of the work item.
 - c) The calculation of Adjusted NOI in paragraph G, below assumes reserve deposits sufficient to meet the long term physical needs of the property over the remaining term of the loan without ever dropping below the amount of one year’s deposits prior to entering the Mark-to-Market Program.
 6. If the project fails to demonstrate **physical soundness**, and all other criteria are met, the PAE should recommend an appropriate approach. One approach that may be appropriate for some transactions is consideration of the property as a Full Debt Restructuring, which would provide funds for rehabilitation. Other alternatives, which would require special procedures and review by the OMHAR Regional Office, are special deposits from the owner to the Reserves for Replacements, or the establishment of a special repair escrow. (Where notable additional work by the PAE is required, the PAE should consider submitting a Form 2.16, requesting the transaction be converted to Tier 2.)
- E. **Determine Market Rents.** The PAE should contract with a State-certified “General” Real Estate Appraiser to perform an independent market study (or, if the property was initially determined to be ineligible as a Lite under Section 10-6.A., the more extensive Limited Scope

Appraisal) as described in Appendix H. In addition to developing an independent market study, the PAE's appraiser should also review the comparable market rents provided in any owner's Rent Comparability Study and visit each comparable property selected by the owner's appraiser. If the PAE's appraiser disagrees with the selection of comparables and/or the comparability adjustments made by the owner's appraiser, the report should document why the comparable/adjustment is inappropriate. Rents will be determined based on the "as-is" condition of the property. (Waivers will be considered for projects where financial commitments exist for improvements that would impact the rents.)

The PAE will review the comparable market rent data provided by the appraiser. In performing this review, the PAE must conduct site visits to the subject and comparable properties. The PAE should visit all of the comparables submitted by its own appraiser. It should also review the comparables of the owner's appraiser if conveniently located, or if necessary to resolve disputes. The PAE should make any appropriate adjustments, and briefly explain the basis for any such adjustments, to arrive at the market rents that the property would command on the open market. The PAE should also provide brief support for its final rent determination, indicating which comparables were most heavily relied upon (averaging the rents of the adjusted comparables is generally not appropriate). PAEs must make this determination as carefully as if debt restructuring were involved.

F. Determine Other Income, Vacancy, and Expense Estimates. In calculating the adjusted NOI:

1. The PAE will use the commercial income, other income (excluding interest income), vacancy and collection losses, and operating expenses from the most recent annual audited financial statements, **if typical**. Typical means representative of stabilized, ongoing operations of the property. The PAE will determine whether there is reason to conclude that the current year's financial statements are typical using the property information submitted, and the PAE's own knowledge and analysis, including consultation with Multifamily Hub or Program Center staff (where appropriate). If vacancy and collection losses or expenses are not thought to be typical, and additional work is necessary to determine appropriate estimates, the PAE should consider submission of a Form 2.16 requesting that the transaction be converted to Tier 2. For example, (a) if it is learned that the vacancy in the property is steadily increasing, possibly due to reductions in the elderly population in the area, or (b) if commercial income in the past has stemmed from an entity that is no longer renting the space or the space is occupied by an identity of interest entity, it

would be appropriate to request conversion to Tier 2 in order to complete a more thorough underwriting.

2. In cases where a typical amount would require a higher vacancy and collection loss factor, a higher operating expense, a lower commercial income, or a lower other income figure *that can be readily determined*, the PAE may justify a specific revision and use the resulting typical figure. (For example, if other income on the most recent statement includes a \$10,000 rebate of prior years' overpayments for Workers' Compensation, that rebate should be excluded in determining typical other income.) If needed, the PAE should obtain two additional prior years' audited statements from the applicable HUD field office or from the owner.
3. Stabilized operating expenses should be trended to bring the estimate up to the time of underwriting. Income may not be trended.
4. The PAE will determine the annual deposit to the Reserve for Replacements *that would be needed* to meet the project's needs over the term of the loan as identified in the PCA (without ever causing the Reserve balance to fall below the amount of one year's deposits the property was making prior to the Mark-to-Market Program). In making the calculation below, the PAE will use that assumed annual deposit. (The actual deposits to the Reserves need *not* be increased, even if the needs are greater than can be covered by the current Reserve balance and current ongoing Reserve deposits, so long as the property meets the debt service requirements specified in paragraph 5 below.)

In the rare case where a reduction to the annual deposit to the Reserve for Replacements is contemplated in the underwriting, the PAE should assure that HUD is specifically advised of this circumstance as they may wish to reduce the deposit. The PAE should not delay completion of their processing awaiting HUD's action.

G. Calculate Adjusted NOI; Determine Financial Soundness.

Take	Gross Potential Market Rents (as determined by the PAE)
Minus	5% vacancy and collection loss factor (or greater, if typical)
Plus	Commercial and Other Income (typical, and excluding interest income)
Minus	Operating Expenses (typical, trended if appropriate)
Minus	Annual Reserve (assumed) deposits sufficient to cover future capital needs
Equals	Adjusted Net Operating Income, for Tier 1

If this Adjusted NOI, divided by the debt service (Principal, Interest and MIP) for the existing FHA-insured loan produces a DSCR of 1.20 or greater, the property meets the **Financial Soundness** criterion.

Lite Tier 2: Review and Underwriting**SECTION 10-8****A. Procedures for Review of a Lite Tier 2 Transaction; Underwriting Standards for Tier 2 Transactions.** The PAE may recommend to OMHAR that a transaction be processed as a Lite Tier 2,

1. if the PAE concludes that it is likely that the expenses or debt service may be able to be reduced sufficiently to achieve financial soundness without restructuring of the debt. If financial soundness can only be achieved through refinancing of existing debt, a substantial reduction in expenses, pay-down of the existing mortgage, or a deposit by the owner to the Reserve for Replacements, the owner must provide a written statement of intent agreeing to the refinancing, reduction, pay down, or deposit before renewal of the new Section 8 HAP Contract.
2. if significant additional work must be done to approve a transaction as a Tier 1 Lite. In these cases, the OMHAR Regional Office will determine, when approving the Form 2.16, what parts of this Tier 2 section apply, if any.

In either case, the PAE will complete the process described in this Section and provide the appropriate support for its conclusions in the Form 10.1.

B. Notification of Tenants. The Notification of Tenants requirements of Section 10-7 B are also applicable to Tier 2 transactions.

C. Approvable Lite Tier 2 Projects. A project is approvable under Tier 2 if it is determined to be physically and managerially sound, and is determined to be financially sound under either of the following standards. Either the property

1. achieves a 1.20 DSCR (using current debt service or a reduced debt service achieved through refinancing of the existing debt with no partial payment of claim) using market rents and the more extensive underwriting described below; or
2. is a stronger property (as defined in paragraph F, below) that achieves a 1.10 DSCR (using current debt service or a reduced debt service achieved through refinancing of the existing debt with no partial payment of claim) using market rents and the more extensive underwriting described below.

D. Lite Tier 2 Underwriting Standards.

To determine if the project meets Tier 2 criteria, the PAE will do the following:

1. Determine Managerial Soundness. The PAE will do the same review and use the same criteria as Tier 1.
2. Determine Physical Soundness. The PAE will do the same review using the same criteria as Tier 1, *except that, in the case of a Section 223(a)(7) refinancing*, ongoing deposits to the Reserve for Replacements will be changed, at the refinancing, to the amount assumed in the NOI Calculation in paragraph E, below.
3. Determine Market Rents. The PAE will do the same review and use the same criteria as in Tier 1.
4. Determine Other Income, Vacancy, Expense, and Reserve Estimates.
 - a) The PAE will *fully underwrite* commercial and other income, vacancy, and collection loss factors. “Fully underwrite” includes review of the most recent three years of operating statements, analysis of the vacancy trends in the property and market, and analysis of the sources of commercial and other income and the likelihood of the continuance of such income. Where there is notable commercial income, full underwriting would include

review of commercial lease provisions and assessment of the likelihood of continuance of this income. The PAE should use no less than a 10% physical vacancy factor and a 5% economic vacancy factor for commercial income.

- b) The PAE will also ***fully underwrite*** expenses and discuss the conclusion with the owner. “Fully underwrite” includes review of the most recent three years of operating statements and line by line analysis of significant expense categories and expense trends. Justifications for expense items may commonly be very brief, but should be more expansive where historic expenses in that line item have been erratic or contrary to expectation. To the extent possible, expenses should be compared to any other sources of expense information and/or verified with outside sources. If the property has been poorly maintained or poorly managed, the PAE should assure that the expenses estimated for maintenance and management are adequate to provide for good maintenance and management.
- c) If the owner agrees that the property can be operated using the expenses determined in the underwriting, the PAE may proceed. If not, the property will be underwritten at a higher level of operating expenses with which the owner does agree.
- d) The PAE will use the same assumed annual deposit to the Reserves for Replacement as in Tier 1 Section 10-7 F.4 above.

E. Calculation of the Adjusted NOI for Tier 2 Transactions .

Take	Gross Potential Market Rents (as determined by the PAE)
Minus	5% vacancy and collection loss factor (or greater, if typical)
Plus	Commercial (after deducting required vacancy allowance) and Other Income (fully underwritten, and excluding interest income)
Minus	Operating Expenses (fully underwritten and discussed with the owner)
Minus	Annual Reserve (assumed) deposits as in Tier 1
Equals	Adjusted Net Operating Income, for Tier 2

If this Adjusted NOI, divided by the debt service (Principal, Interest and MIP) for the existing FHA-insured loan produces a DSCR of **1.20 or greater**, the property meets the **Financial Soundness** criterion.

F. **Lite Tier 2: Options For Meeting Financial Soundness Test.** If the property does not produce a 1.20 DSCR, the PAE can consider the following five options.

1. *Recommend Approval at Reduced DSCR for Strong Properties:*

If the DSCR is **1.10 or greater**, and an adequate case can be made that the property is a strong candidate for long-term successful operations with this reduced DSCR, the PAE may recommend approval. The PAE's supporting documentation should include consideration of any information provided by REAC and the HUD field office, including HUD's prior management reviews. A "strong" property should meet the criteria below. Consideration should also be given to properties that have operated successfully at less than 1.20 DSCR for some time.

- a) The property is located in a strong market with little likelihood of a reduction in demand resulting from decreases in the eligible population due to a general population decline, job losses, weaknesses in the predominating industry, increases in the housing stock, or similar conditions.
- b) The property is in good condition, as evidenced by the REAC score, PCA, and PAE inspection and the current owners maintain it in acceptable condition.
- c) The property has had a comparatively stable rent, vacancy, and expense history over the past three years and there is no reason to believe that this would change in the future as a result of anticipated utility increases, the end of tax abatements, or similar foreseeable factors.
- d) Considering tenant comments, prior HUD reviews and the PAE's review, the property has sound management with an acceptable history.
- e) Based on the PAE's inspection, the PCA, market study and tenant comments, the property has no features such as extremely small units, poor location, or other factors that would render it non-competitive in a market situation.

2. *Recommend Approval if the Property **Could** Produce an Acceptable Debt Service Coverage Ratio (DSCR) with Refinancing of Existing Debt:* If the property **could** produce a DSCR of 1.20 or greater, or a DSCR of 1.10 or greater for a strong property, with a refinancing of the existing debt using generally available rates and terms and FHA mortgage insurance (or risk-

sharing), the PAE may recommend approval provided that the owner's commitment to refinance is satisfactory to the Multifamily Hub or Program Center. Where the property could be viable with a 223(a)(7) refinance, PAEs should refer owners to the local Multifamily Hub or Program Center responsible for processing applications for firm commitment. PAEs are encouraged to assist the local HUD office and lender upon request by providing any relevant data.

3. *Recommend Approval, if Owner Provides Evidence of Financing Commitments Not Involving FHA Mortgage Insurance or Risk-sharing:* If the owner provides evidence of a commitment to refinance the existing FHA-insured loan without using full FHA mortgage insurance or FHA risk-sharing, and the PAE, OMHAR, and the Multifamily Hub or Program Center find the commitment satisfactory, the PAE may recommend approval. The owner must provide evidence of closing of the refinancing prior to the next Section 8 HAP Contract extension.
4. *Recommend Approval, if Deviations are De Minimis:* If the amount of dollars or percentage points by which the property fails to meet the DSCR criteria is de minimis, recommend approval. Such cases should be discussed with the OMHAR Regional Office before submission.
5. *Recommend the Owner Change his or her Election Under H 99-36:* If the results are such that a Lite, Tier 2 is not feasible, the PAE should proceed as described in the applicable portions of Section 10-6 E, and following.

Appeal Process for Lites

SECTION 10-9

In most cases, the owner has **one** opportunity to appeal the OMHAR decision related to the determination of market rents and, if applicable, the determination that the transaction is ineligible as a Lite. The PAE will notify the owner of its appeal rights as part of the form notification letters.

The exception is the case where a transaction is initially identified as ineligible as a Lite under Section 10-6 A, and the rents have not yet been determined. In this case, the owner has one opportunity to appeal the determination of ineligibility as a Lite and a second opportunity to appeal the rents.

The owner will have 20 days from the date of the notification to appeal to the OMHAR Regional Office, addressing all points of disagreement. The OMHAR

Regional Office will review the appeal, discuss it with the PAE, make a final determination and respond within 30 calendar days of receipt of the owner's appeal with a copy of its determination to the HUD Project Manager, Section 8 Contract Administrator and the PAE.

Task Summary

SECTION 10-10

PAE		
TIMELINE	TASK	TEAM
Submission		
	Asset received by OMHAR HQ for processing	OMHAR HQ
Initial Processing		
Within 75 days of assignment	Per the PRA, to earn an incentive fee, the PAE completes processing of Lite Tier 1	
Within 90 days of assignment	Per the PRA, the PAE completes processing of a Lite Tier 1	
Within 90 days of assignment	Per the PRA, to earn an incentive fee, the PAE completes processing of a Lite Tier 2	
Within 120 days of assignment	Per the PRA, the PAE completes processing of a Lite Tier 2	
Lite Processing and Section 8 HAP Contract Processing		
Initial Review: Immediately after assignment	<p>If has adequate information from owner, determines current DSCR. If existing DSCR is lower than required for approval as Tier 1 or 2, the PAE:</p> <ul style="list-style-type: none"> · notifies owner of ineligibility of Lite (Form 10.6(b)), offering option to change election under H 99-36 · orders third party reports (Market Study/Limited Scope Appraisal, as appropriate) 	Owner
After initial review	<p>Follows procedures in Section 10-7 of the OPG. If transaction can be approved as a Lite Tier 1, PAE:</p> <ul style="list-style-type: none"> · completes electronic submission (Form 10.2) · submits narrative and conclusion (Form 10.1) and a print out of the electronic submission (Form 10.2) to the OMHAR RO · notifies owner of market rent determination and transmits Section 8 HAP Contract for execution with notification that current contract expires at the end of the next full month, with copies to the HUD Project Manager, the Section 8 Contract Administrator and the OMHAR RO · Updates M2M MIS data with date Section 8 HAP Contract is sent to owner, and date executed Section 8 HAP Contract received from owner 	OMHAR RO Owner HUD Project Manager Section 8 Contract Administrator
	<p>If project fails as a Tier 1, but may be approvable as Tier 2, the PAE:</p> <ul style="list-style-type: none"> · submits Form 2.16, Change of Asset Status, to OMHAR RO; · follows procedures in Section 10-7 of the 	OMHAR RO Owner

PAE		
TIMELINE	TASK	TEAM
	OPG <ul style="list-style-type: none"> · after approval discusses transaction with owner · Updates M2M MIS data with date Section 8 HAP Contract is sent to owner, and date executed Section 8 HAP Contract received from owner 	
	If not eligible for Lite Tier 1 or 2, <ul style="list-style-type: none"> · submits Form 2.16 to OMHAR RO with justification for processing as a Full Debt Restructuring 	OMHAR RO
	If OMHAR RO agrees with PAE that Full Debt Restructuring is necessary, the PAE: <ul style="list-style-type: none"> · requests teleconference or meeting with owner · advises and invites participation of Multifamily Hub or Program Center (and Section 8 Contract Administrator, if not HUD) · advises owner of tentative conclusions and explains owner options · sends Form 10.6 (a) or (b) notification to owner with copy of election form · notifies owner of 20 day appeal period and supplies information as necessary 	OMHAR RO Owner Multifamily Hub or Program Center Section 8 Contract Administrator (if not HUD)
At completion of Lite Processing	Submits completed Credit File (Form 10.9) and Contract File to OMHAR RO	OMHAR RO
Appeal Process		
	PAE notifies owner of appeal rights as part of notification form letters.	Owner
	If requested by owner, may provide the PCA and Market Study/Limited Scope Appraisal (if completed), the draft income and expense spreadsheet, and PAE's justification for selection of market rents by overnight mail	Owner
	If appeal results in increase in market rents, PAE: <ul style="list-style-type: none"> · sends Form 10.5 and revised Section 8 HAP Contract to the owner, and · provides a copy using Form 10.4(b) to the HUD Project Manager, with copies to Section 8 Contract Administrator and OMHAR RO 	Owner PAE HUD Project Manager Section 8 Contract Administrator
	If owner refuses Full Debt Restructuring or fails to respond to PAE's, PAE completes processing transaction as a Lite	Owner OMHAR RO
	OMHAR RO may call upon PAE to discuss an owner appeal during review process	OMHAR RO

OMHAR Headquarters		
TIMELINE	TASK	TEAM
Submission		
	Receives owner's request for a Lite under H 99-36 (or subsequent guidance) from the Multifamily Hub or Program Center	Multifamily Hub or Program Center
	Asset Assignment Specialist assigns the asset to the appropriate PAE for processing, and notifies OMHAR RO	PAE OMHAR Regional Office
Lite Processing and Section 8 HAP Contract Processing		
	OMHAR Section 8 Coordinator reviews M2M MIS reports to track dates input by PAE for overdue contracts; takes appropriate steps to resolve issues with PAE and owner to either obtain the signed Section 8 HAP Contract or initiate the process for tenant-based assistance	PAE Owner Multifamily Hub or Program Center
After request for Change of Asset Status	Processes the Form 2.16 request for change of asset status to either a Lite Tier 2 or a Full Debt Restructuring when forwarded by the OMHAR RO. Once approved Asset Assignment Specialist notifies the PAE	OMHAR RO PAE

OMHAR Regional Office		
TIMELINE	TASK	TEAM
Submission		
	Receives notification of asset assignment to a PAE from OMHAR HQ	OMHAR HQ
	Responds to PAE questions at any time	PAE
Lite Processing and Section 8 HAP Contract Processing		
	Receives Forms 10.1 and 10.2 from the PAE <ul style="list-style-type: none"> · reviews PAE recommendation for Lite Tier 1 · obtains necessary corrections · accepts or adjusts market rents · drafts a new Section 8 HAP Contract for execution by owner (using appropriate form from H 99-36) 	PAE
	Sends copy of Section 8 HAP Contract to the HUD Project Manager to cancel prior contract and reserve funds	HUD Project Manager
	Reviews PAE request for Change of Asset Status (Form 2.16) to a Tier 2 Lite or a Full Debt Restructuring, requests additional information, if necessary, and forwards to the OMHAR HQ Asset Assignment Specialist	PAE OMHAR HQ
At completion of Lite Processing	Receives Credit File (Form 10.9) and Contract	PAE

OMHAR Regional Office		
TIMELINE	TASK	TEAM
	File from the PAE	
Appeals Process		
	If owner appeals, OMHAR RO has 30 days to review and respond; may call upon PAE to discuss appeal during review process	PAE
	If appeal results in increase in market rents, OMHAR provides a revised Form 10.3(a) and revised Section 8 HAP Contract to the PAE with copies to the HUD Project Manager and Section 8 Contract Administrator	Owner PAE HUD Project Manager Section 8 Contract Administrator
	If appeal does not result in an increase in market rents, OMHAR notifies owner, using Form 10.7(a), as appropriate, with copies to the HUD Project Manager, Section 8 Contract Administrator, and the PAE within 10 business days	Owner PAE HUD Project Manager Section 8 Contract Administrator
	If an owner's appeal of determination of need for a full restructuring: <ul style="list-style-type: none"> · is rejected, OMHAR notifies owner with Form 10.7(b) within 10 business days, and owner has an additional 5 business days to revise their election under H-99-36 · is accepted, OMHAR advises PAE and owner how to proceed 	Owner PAE Multifamily Hub or Program Center

Owner		
TIMELINE	TASK	TEAM
Submission		
	Owner submits request for a Lite under H 99-36 (or subsequent guidance) with initial information on rents and expenses for PAE analysis of DSCR to the Multifamily Hub or Program Center	Multifamily Hub or Program Center
	Owner is notified of asset assignment to PAE by OMHAR HQ	OMHAR HQ
Lite Processing and Section 8 HAP Contract Processing		
	Receives Section 8 HAP Contract, with market rent determination (Form 10.4(a)) for execution (includes guidance on appeals)	PAE
	Executes Section 8 HAP Contract within 10 days of receipt from PAE, and provides it to the HUD Project Manager, with a copy to the PAE	HUD Project Manager PAE
	If ineligible for a Lite, and owner elects Full Debt Restructuring, provides revised election under H 99-36 to Multifamily Hub or Program Center	Multifamily Hub or Program Center PAE

Owner		
TIMELINE	TASK	TEAM
Appeals		
	May request PCA and Market Study/Limited Scope Appraisal (if completed), the draft income and expense spreadsheet, and PAE's justification for selection of market rents from the PAE	PAE
After determination as ineligible as Lite	May appeal determination of market rents and/or ineligibility of within 20 days of notification	PAE OMHAR RO

Multifamily Hub or Program Center/HUD Project Manager		
TIMELINE	TASK	TEAM
Submission		
	Receives owner's request for a Lite under H 99-36 (or subsequent guidance), logs in the request, forwards the asset to OMHAR HQ for assignment to a PAE, and updates the REMS system for the type of renewal requested.	Owner OMHAR HQ
Lite Processing and Section 8 HAP Contract Processing		
	HUD Project Manager receives Section 8 HAP Contract from the OMHAR RO to begin the fund reservation process	OMHAR RO
	Receives cover letter from PAE (Form 10.4(b)) with the market rent determination for the Section 8 HAP Contract	PAE
	Update REMS system when processing is completed	
After approval as Tier 1	Terminates existing Section 8 HAP Contract as described in Form 10.4(b), and prepares fund reservation and execution process for new Section 8 HAP Contract when received from owner	Owner PAE
	If owner does not execute Section 8 HAP Contract as required in the notice, HUD may prepare to issue Section 8 tenant-based assistance to tenants in the property	Owner
	If owner elects Full Debt Restructuring, receives revised election under H 99-36 and reassigns to OMHAR as a Full	Owner OMHAR RO
Appeals		
	If owner refuses Full Debt Restructuring or fails to respond to PAE's letters, OMHAR forwards conversion recommendation to HUD Project Manager and Section 8 Contract Administrator, and HUD determines whether to execute the Section 8 HAP Contract or convert to tenant-based assistance	OMHAR RO Owner PAE Section 8 Contract Administrator

Section 8 Contract Administrator		
TIMELINE	TASK	TEAM
Lite Processing and Section 8 HAP Contract Processing		
	Receives copies of PAE notifications (e.g., market rent determinations, revised determinations)	PAE
	Receives copy of OMHAR notifications on	OMHAR RO

Section 8 Contract Administrator		
TIMELINE	TASK	TEAM
	appeals	
Appeals		
	If owner refuses Full Debt Restructuring or fails to respond to PAE's letters, OMHAR forwards conversion recommendation to HUD Project Manager and Section 8 Contract Administrator, and HUD determines whether to execute the Section 8 HAP Contract or convert to tenant-based assistance	OMHAR RO Owner PAE Multifamily Hub or Program Center

List of Business and Legal Forms

SECTION 10-11

No.	Title
10.1	OMHAR Reduction of Rent and Section 8 HAP Contract Renewal Justification and Cover Page
10.2	Electronic Submission of PAE's Lite Conclusions
10.3(a)	Market Rent Determination; Transmittal of Section 8 HAP Contract
10.3(b)	Agreement with PAE's Determination of Ineligible Rents; Market Rent Determination
10.3(c)	Ineligible Lite/Conversion to Full Refused; Market Rent Determination; Transmittal of Section 8 HAP Contract
10.4(a)	Notification to Owner of Market Rent Determination; Transmittal of Section 8 HAP Contract
10.4(b)	Notification to HUD Project Manager of Market Rent Determination; Transmittal of Section 8 HAP Contract
10.5	Notification to Owner of Results of Appeal of Market Rent Determination; Transmittal of <i>Increased</i> Market Rents and Revised Section 8 HAP Contract
10.6(a)	Notification to Owner of Ineligibility as a Lite; Transmittal of Form for Re-Election under Housing Notice H 99-36
10.6(b)	Notification to Owner of Ineligibility as a Lite based on <i>Initial Review</i> (Section 10-6A); Transmittal of Form for Re-election under Housing Notice H 99-36
10.7(a)	Notification to Owner of Failure of Appeal
10.7(b)	Notification to Owner of Failure of Appeal; Transmittal of Form for Re-election under Housing Notice H 99-36
10.8	Notice to Owner / Conversion Refused; Determination of Market Rents
10.9	Lite Credit File Checklist
10.10	Notice of Rent Reduction Without Debt Restructuring